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WEEKLY OUTLOOK

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NEW LIFE FOR SOYBEAN PRICES

Soybean prices were under pressure in early February, but increased sharply last week. The higher prices came in spite of USDA projections for even larger U.S. and world stocks at the end of the current marketing year.

March 2005 soybean futures traded under $5.00 on February 4, but closed at $5.2575 on February 11. The average spot cash bid in central Illinois increased from $4.97 to $5.24 as the basis improved slightly. On February 9, the USDA released its monthly projection of U.S. and world supply and consumption of soybeans, as well as other commodities. For soybeans, the changes from January included a 5 million bushel reduction in the projection of the size of the domestic crush during the current marketing year and an equal increase in the projection of year ending stocks. Even with a smaller crush, the projection of U.S. soybean oil production increased by 10 million pounds, reflecting the relatively high oil content of the 2004 crop. The projection of the marketing year average price of soybean oil was reduced by $.01 per pound. In addition, the projection of domestic meal consumption was reduced by 200,000 tons. The smaller projection of meal use in the domestic market is the reason fewer soybeans will need to be crushed.

For South America, the USDA reduced the projection of the current Brazilian crop by 55 million bushels (2.3 percent). Production forecasts also declined by 6 million bushels for Uruguay and 18 million bushels for India. However, the projection of South American soybean consumption was reduced by 75 million bushels and the projection of world soybean consumption during the current marketing year was reduced by almost 110 million bushels. As a result, the projection of year ending world stocks increased by 20 million bushels, to a record 2.254 billion bushels, or 30 percent of projected use during the current marketing year.

So why the increase in price of soybeans in the face of such large U.S. and world supplies? The answer seems to be that the large speculative traders decided to reduce their net short position in the futures market. But, that answer begs the question of why those traders wanted to give up some of those short positions. Fundamentally, there appears to be three reasons. First is the continuation of strong Chinese demand for

U.S. soybeans. Second, the reduction in the Brazilian production forecast caused traders to take a fresh look at south American crop and weather conditions. Third is prospects for a smaller soybean crop in the U.S. in 2005.

As of February 3, the USDA reported total U.S. soybean export commitments for the current marketing year at 870 million bushels, 40 million more than on the same date last year. For the year, the USDA currently projects a 125 million bushels increase in exports from those of last year. Given the collapse in exports during the last half of the 2003-04 marketing year (due to limited supplies) the projected large year-over-year increase should be reached, or perhaps exceeded. Total Chinese demand and China's decision about how many South American soybeans to purchase will be important. To date, China accounts for 42 percent of the U.S. export business, compared to 36 percent at this time last year.

As for South American production, market participants now seem to believe that the crop has suffered more weather damage than previously indicated. The concern is that the crop will even fall short of the revised USDA projection. At this juncture, there is no talk of a repeat of the 2004 experience when early season forecasts of a large increase in South American production gave way to a smaller crop than harvested in 2003.

In the case of the 2005 U.S. crop, there is a general expectation that planted acreage will decline for a variety of reasons, including the threat of soybean rust. In addition, some experts are reporting the potential for a problem with soybean aphids in 2005. Some climatologists are also suggesting a higher than average probability of drought conditions in some areas in 2005. These factors all contribute to yield uncertainty for the year ahead.

For now, the uncertainty surrounding South American crop size and U.S. production potential is apparently enough to offset the impact of current large supplies. Additionally, U.S. producers reportedly continue to be reluctant sellers, keeping basis levels strong. Soybean prices will likely become more volatile over the next several weeks as South American production prospects unfold. The USDA will release the *Prospective Plantings* report on March 31. Further price rallies may offer producers an opportunity to price additional quantifies of both old and new crop soybeans at levels well above the loan rate. Due to the increased uncertainty about the size of the 2005 U.S. crop, producers may want to consider the use of options in pricing the new crop. A poor crop could push prices higher than anticipated at this juncture, while a large corp could produce the train wreck that has been avoided so far.

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